Joint Board's goals in that proceeding. On reconsideration, the FCC decided to include access revenues in the allocation factor for marketing expenses as an interim measure pending the outcome of a further inquiry by the Joint Board.[16] That issue is still pending before the Joint Board.[17]

3. Avoiding Use of the Subscriber Line Charge

For purely political reasons, the FCC and Joint Board were extremely reluctant to include the costs of subscriber plant in the subscriber line charge, even where that mechanism was the most efficient form economic recovery. A classic example of that reluctance was the separations and access charge treatment of Local Dial Switching Equipment.[18]

Under the former Part 67 procedures, carriers were required to divide their investment in the former Category 6 Central Office Equipment (COE), Local Dial Switching Equipment, into nontraffic sensitive and traffic sensitive components. The nontraffic sensitive component was allocated on the basis of the frozen SPF, whereas the traffic sensitive component was

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[16] MTS and WATS Market Structure, Memorandum Opinion and Order on Reconsideration, 2 FCC Rcd 5349 at paras. 24-26 (1987).

[17] See Expanded Interconnection, 7 FCC Rcd. 7369 at n. 336 (1992). It has been alleged that more than 25 percent of the LECs' total marketing expenses are assigned to the interstate jurisdiction when access revenues are included in the allocation factor. See, e.g., Amendment of Part 36, Order Inviting Comments and Request for Data, 3 FCC Rcd 2774 at para. 8 (1988).

[18] Examples of Local Dial Switching Equipment include basic switching train, toll connecting trunk equipment, interlocal trunks, tandem trunks, terminating senders used for toll completing, toll completing trains,cal reverting equipment, weather and time of day service equipment, concentration equipment, and switching equipment at electronic-analog or digital remote line locations. See Amendment of Part 67, Recommended Decision and Order, 2 FCC Rcd 2551 at para. 3 (1987).

allocated on the basis of DEM, which included toll weighing factors (TWFs).[59] Under the former Part 69 rules, carriers were required to apportion costs between three end office elements: Line Termination, Local Switching, and Intercept.[60]

Effective January 1, 1988, the FCC revised the Separations Manual, pursuant to Joint Board recommendations, to consolidate the former Category 6 COE, Local Dial Switching, with other switching categories to form a new category, COE Category 3, Local Switching Equipment.[61] This new category was allocated between the jurisdictions on the basis of DEM. In other words, the FCC eliminated the traffic sensitive/nontraffic sensitive distinction applicable to Local Switching Equipment, allocating on a relative usage basis as though such costs were all traffic sensitive.[62] The LECs were also required to phase-in the DEM allocation factor over the 1988-1992 period in order to forestall substantial shifts in costs from

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[59] TWFs were intended to reflect the then higher cost of usage of the switch by toll calls, which are trunk side connections, rather than local calls, which are line side connections.

[60] Local Switching was divided into two subelements: Local Switching 1 and Local Switching 2. The former Line Termination and Local Switching elements reflected the classification of the former Category 6 COE, Local Dial Switching Equipment, into traffic sensitive and nontraffic sensitive portions for jurisdictional separations purposes. The differences in the former LS1 and LS2 subelements of the Local Switching element reflected the TWFs applied to toll minutes for the purpose of allocating the traffic sensitive portion of the former Category 6 COE.

[61] The former COE categories included: Category 4 Automatic Message Recording Equipment; Category 5, Other Toll Dial Switching Equipment; and Category 7, Special Services Switching Equipment.

[62] The FCC believed that because digital switching equipment was presumably comprised mainly of traffic sensitive components, a flat allocation factor would be inappropriate. 3 FCC Rcd 5518 at para. 49. The FCC also eliminated the use of TWFs and the LS1 discount on the assumption that with the use of modern switches, use of the switch for toll calls is no longer more costly than for local calls. See, e.g., 4 FCC Rcd 765 at para. 7 (1988).

the interstate jurisdiction to the state jurisdiction which were anticipated if the new procedures were implemented on an immediate basis.[93]

While eliminating the traffic sensitive/nontraffic sensitive distinction and allocating all Local Switching Equipment as if it were traffic sensitive have simplified the interstate treatment of such equipment, such changes have also created an uneconomic recovery mechanism.[94] Over time, it has become increasingly clear that the nontraffic sensitive portion of Local Switching Equipment is greater than was publicly predicted by the FCC and the Joint Board.[95] Whereas the determination of which size switch to install is clearly a traffic sensitive decision,[96] a local switch exhibits many of the same cost factors as nontraffic sensitive local loop;[97] once it is installed, the switch incurs virtually no additional costs based on the traffic it handles.

93/ On the access charge side, the FCC combined Line Termination, LS1 and LS2 into a single access element that was assessed on the basis of unweighted access minutes. The FCC also established a transition mechanism to eliminate the rate differential between the LS1 and LS2 subelements.

94/ Moreover, the combining of COE categories and the five year phase-in perpetuated an overallocation to the interstate jurisdiction.

95/ Indeed, technical advances in local dial switching have increased the amount of nontraffic sensitive switching costs currently being recovered in Local Switching rates. Recent studies performed within NYNEX using switch vendor-provided information and considering other usage and size parameters provided by NYNEX traffic engineers, reflect that the average percentage nontraffic sensitive costs range from 6% for analog electronic switching systems to an average of 51% for the most modern digital systems.

96/ "Even if virtually all switching costs become fixed when the switch is installed, the decision to install a large switch rather than a small switch or to install five switches rather than four is affected by the anticipated traffic volume." 3 FCC Rcd 5518 at para. 47.

97/ The nontraffic sensitive portion of the local switch is a function of the number of loops it supports, not the volume of traffic.

Everyone involved in the separations and access reforms applicable to Local Switching Equipment fully understood that the nontraffic sensitive portion of local switches is identical to the local loop, the costs for which it was clearly more proper to treat like other subscriber plant and include as part of the subscriber line charge accessed to the end user customer.[68] The only reason such costs were excluded from the subscriber line charge was because, at that time, the FCC was in the midst of a controversy of attempting to recover, for the first time, any costs directly from end user subscribers. To have proposed increasing the subscriber line charge to include recovery of local switching could have jeopardized the entire subscriber line charge effort because of fears that customers would become overburdened with interstate costs, which ultimately could harm universal service. While the political decision to exclude local switching costs from the subscriber line charge was arguably justifiable at the time the decision was made, it needs to be reassessed to reflect the situation that exists today. Namely, in a competitive environment, attempting to recover the costs of subscriber plant through loadings is doomed to failure.

V. CONCLUSION

This history demonstrates that the Local Transport disparity as well as the price/cost mismatch in other interstate accounts are the direct result of decades of rules deliberately designed to overallocate costs to the interstate jurisdiction to subsidize local rates. As illustrated above, the FCC and the Joint Board were well aware of the large number of interstate accounts with extra costs even as they moved to more economic pricing. These

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[68] Moreover, the nontraffic sensitive portion of such equipment is used to support the local loop, not the provision of carrier access services. See, e.g., NYNEX RIC Analysis, supra note 3, Service-Specific Cost Study, Section 2 at Attachment A, page 2.

manipulations of the separations process were part of a deliberate attempt by decisionmakers to advance various political and policy goals rather than merely to foster economically efficient pricing:

> [Any characterization of separations as] a small, technical process of no particular importance . . . is a totally untenable position. The rapid growth of separations charges could not have escaped the attention of even the densest regulator. Everyone connected with telecommunications ... knew that local telephone service was being supported more and more by revenues from interstate traffic. Anyone who thought about the amount of money involved must have understood that this was hardly the unintended fallout of a jurisdictional decision in 1930. It was instead the result of an ongoing political process that can be seen in the pressure Senator McFarland put on the FCC in 1950, as well as Congressional pressure on the Commission not to impose end-user charges in 1983. Some interested parties chose to disregard all of these factors, sowing confusion among the uninitiated and impugning AT&T's attempts to explain it. But the fact of the giant subsidy remained.[42]

The revisions to the Separations Manual undertaken in the 1980s made meaningful, but modest, progress in stemming the growth of misallocated interstate costs and in beginning to collect the misallocated costs in a reliable and efficient manner. Many of the separations abuses of the 1970s were checked and important strides toward more economically efficient interstate pricing were undertaken.

However, the principle reforms of the 1980s were in the access arena and, as a practical matter, only made minor strides in reallocation reform of the separations process. It was understood by all parties at the time that reforms such as the subscriber line charge were merely a first step and that further reform would be needed in the future. Such reforms were aimed only at the most egregious overallocations; as illustrated above, other interstate accounts still are in need of change. Moreover, the cost recovery mechanisms undertaken by

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[42] Temin at 358.

the FCC and the Joint Board enhanced reliability, although the "equal per unit traffic" rule to which the FCC acquiesced, but did not create, significantly eroded the efficiency of such reforms. In addition, such reforms were based upon circumstances (e.g., the onset of long distance competition) that have since undergone significant evolution. Perhaps most significantly, high levels of competition to local access service, viewed only as a distant possibility in the 1980s, is now a certainty. And just as long distance competition crystallized the urgent need for reform in the 1980s, local competition in the 1990s makes existing misallocations at least as untenable. While revisions to the Separations Manual that occurred in the past were beneficial, additional actions in both the separations and access charge arena must be taken to address the new realities of today.

Although the specific reforms needed are beyond the scope of this paper, as it did in the past, the FCC should reject calls to automatically shift all misallocated costs to the states. Instead the Commission should remain involved in the process to ensure the reliable and efficient recovery and reallocation of such costs.[20] Despite its shortcomings, the separations rules are a product of a careful balance, over several decades, of state/interstate costs based on public policy determinations, some of which continue to remain relevant today. As a consequence, addressing the amounts of contribution remaining in interstate carrier access rates should not merely be through shifts to the state jurisdiction, but through reforms within the interstate arena that permit a more economically efficient and reliable recovery of costs in light of the technological, competitive, and political realities of today.

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[20] Moreover, as in the past, it may often be advisable to phase-in any reallocations to the state jurisdiction to avoid rate shock.

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